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C O N F I D E N T I A L SECTION 01 OF 02 LAGOS 000536

SIPDIS

DEPARTMENT PLEASE PASS TO EXIMBANK

E.O. 12958: DECL: 04/08/2015
TAGS: EFIN ECON ETTC KTFN PTER NI
SUBJECT: NIGERIAN BANKS IN DISTRESS?

REF: ABUJA 383

Classified By: Consul General Brian Browne for reasons 1.4 (b) and (d).

¶1. (C) Summary. With nine months remaining to meet the December 2005 naira 25 billion (USD 192 million) recapitalization deadline, banking sector noise has amplified. While the banks publicly talk positive about the future, we have heard rumors of liquidity problems at some banks. We believe that these problems are not generalized throughout the industry, and thus do not signify systemic distress. Despite these blips and the regulatory hard time that weaker banks may soon face, we view the long-term outlook for Nigeria's banks as generally positive. End summary.

¶2. (SBU) Last July, the Central Bank of Nigeria (CBN) directed that Nigerian banks recapitalize to naira 25 billion (USD 192 million) by the end of 2005. Halfway to the CBN deadline, the sector is predictably active. More than 50 of the country's 89 banks have participated in merger talks or have engaged in public offerings on the stock exchange or private placements in order to raise their capital base. Investors and depositors have been taking second and third looks at various banks to determine the safest one to place their funds.

¶3. (C) Credible reports suggest a few banks considered to be "safe", including Zenith Bank, one of the nation's largest banks, and City Express Bank, have been unable at times to immediately honor depositors' requests to withdraw money. Were such rumors true, some banks might be facing liquidity problems that could lead to panic, if publicized. However, most of Nigeria's 15 largest Nigerian banks including Zenith and City Express Bank are considering major investments in: credit card services, software upgrades, and branch expansion. These activities are capital and time intensive, and would tend to contradict reports that these banks are distressed.

THE FATE OF BANKS: LARGE BANKS WILL LIVE AND SMALL BANKS WILL BE ABSORBED
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¶4. (C) Whatever the state of the industry, Chris Onyemenam, Head of the Research and Economic Intelligence Group of Zenith Bank, predicts the GON will not allow Nigeria's large banks to fail. He reasons the CBN recapitalization directive is meant to strengthen the banking sector as part of the GON's overall economic reforms. Both CBN Governor Soludo and President Obasanjo have said that probably fewer than 20 banks will exist after December 2005. Most industry watchers expect 25 - 50 banks to remain in business, however.

¶5. (U) Initially, the CBN had taken a hard line insisting banks that have not been contributing to the Nigerian economy through bona fide banking services would not be acceptable candidates for recapitalization. The CBN was then encouraging mergers and acquisitions as a way for these and other non-viable banks to retain value. Ideally, the exercise was expected to lead to a more transparent banking sector, with the bad banks eventually dissolved. As the deadline for recapitalization nears, however, the CBN faces the reality that the larger banks have little or no interest to merge with or acquire many of the smaller banks. Most of the larger banks have met the naira 25 billion requirement on their own, or are expected to do so by December 2005. The large banks clearly prefer to avoid the pain of absorbing the weaker banks.

¶6. (SBU) It is doubtful the CBN envisaged roughly 50 of Nigeria's small banks failing to meet the recapitalization deadline, because they could not consolidate with several other small banks or be absorbed by the larger banks. The CBN wanted to rid the system of banks that existed merely because their board members were politically well-connected and assured bank access to public deposits. However, widespread small bank non-compliance with the recapitalization directive could cause significant problems. To preclude this outcome, the CBN is now saying it will offer incentives to the larger banks to acquire the smaller ones. While some larger banks may do this, in the end, many smaller banks are likely to fail, according to Bismarck Rewane, CEO of Financial Derivatives.

¶7. (C) Whether most of Nigeria's small banks will exist or not after December 2005 is an open question. Widespread insolvency of the small banks would affect confidence in the entire banking sector, though the large banks would not be hit as hard as the small banks. The depositors susceptible to panic would be the less-educated depositors who hold small accounts, and who would be less able to distinguish between the problems of the smaller banks and the opportunities of the larger ones. Savvier depositors already prefer the large banks and believe, like some industry experts, the GON will not let the larger banks drown. The larger institutions are the banks that will attract GON public funds, which comprised an estimated 40 percent of total bank deposits. While most of Nigeria's elite also believe the GON will not let the larger banks fail, these people, who hold most of Nigeria's wealth, traditionally shelter a large part of their holdings in foreign banks.

¶8. (SBU) For most Nigerians who do not use banks or who have only small deposits, the generalized collapse of the banking system would reinforce what they already believe: money is safer under the mattress than in the bank. But Nigeria's dwindling middle class would suffer most if the banking sector faltered. The Nigerian Deposit Insurance Corporation (NDIC) guarantees deposits only up to naira 50,000 (USD 382.00), a figure lower than the average bank deposit of the middle-class Nigerian. After the recapitalization is implemented, the NDIC may raise the guarantee to naira 200,000 (about USD 1525.00).

¶9. (SBU) On balance, industry experts believe the CBN's reform efforts are positive. These experts do not believe recapitalization will provoke the worst-case scenario; that is, systemic distress within the banking sector. They expect ups and downs in the process, and that many banks will cease to exist. By early 2006, we can expect other questions to arise, as sector experts now predict from 20 to 50 banks may meet the December 2005 recapitalization requirement. The CBN may try to employ additional measures to further reduce the number of banks to its original target, particularly if the CBN still believes it has not flushed out enough of the banking sector's detritus. Regardless of the number of banks that survive into 2006, bankers will face the challenge of delivering the higher returns investors, who helped their banks reach the naira 25 billion goal, will expect.

¶10. (SBU) An underlying assumption of the entire process is that the higher capitalized banks will embark on more high-end financing. A key question that must be answered is whether banks will have the expertise to assess the elements of risk associated with large-scale projects they may have to finance to meet their investor expected returns? Kola Ayeye, the Managing Director of National Bank, speculates more banks will follow the route of United Bank for Africa (UBA) and Standard Trust Bank (STB), both of which are undergoing a merger, and will retain international consultants to guide them through the merging process and initial risk assessment activities. However, Rewane, of Financial Derivaties, believes many banks will continue to use in-house expertise and will, as a result, experience some set-backs due to less than optimal assessments.

¶11. (SBU) Comment. It is a near certainty that numerous banks will fail due to the weight of the recapitalization requirement. Nigeria's regulatory and legal institutions such as the CBN, the Nigerian Deposit Insurance Corporation (NDIC), the Nigerian Stock Exchange (NSE), the Securities Exchange Commission (SEC), and the court system will have to be ready to handle these failures. If not, it could dent investor and overall confidence in the sector. Moreover, should large deals go bad, some of the support structure may not be in place to minimize impact on the economy. The CBN (reftel), the NDIC, the SEC, and the NSE have shown signs they are ready to take on some of the banking sector's big challenges; however, it is questionable whether Nigeria's legal system can cope with multi-billion naira default cases that could arise from risky projects going south. End comment.
BROWNE